THE DAYTON COMPANY ■ ANNUAL REPORT 1965

Artist Harry Bertoia's "Golden Trees," in the Garden Court at Southdale

Financial Highlights

	1965	*1964*	*Percent Increase*
Net Retail Sales	$186,166,671	$162,773,739	14
Income Before Taxes	14,233,981	9,616,914	48
Percent of Sales	7.6	5.9	
Net Income After Taxes	7,128,981	5,435,205	31
Percent of Sales	3.8	3.3	
Earnings Per Common Share*	1.99	1.41	41
Net Worth	55,775,862	49,997,553	12
Working Capital	31,051,857	26,245,860	18
Common Shares at End of Year*	3,165,500	3,249,500	

*Adjusted to reflect stock split and stock dividend on March 2, 1966

FOUR GENERATIONS of Midwesterners have looked to Dayton's for "firsts" in fashions, promotions and community relations. Their success in finding them is reflected in the growth of The Dayton Company from one Minneapolis store, founded in 1902, to a modern corporation with three expanding divisions in the department store, discount and land development fields. ■ Dayton's was founded by George Draper Dayton, a southern Minnesota banker who bought a dry goods company in Minneapolis and established it, a few months later, in his new building on its present site. Acquisition of adjacent properties and a series of seven major expansions have culminated in a 12-story department store with 1,330,000 square feet of space. ■ The Company's first expansion outside downtown Minneapolis took place in 1954, when a full-line Dayton's was established in Rochester, Minnesota, home of the Mayo Clinic. In 1956, Dayton Development Company opened Southdale in southwest suburban Minneapolis, the first fully-enclosed, air-conditioned shopping center in the world, with approximately one million square feet of space under a single roof. Operations were extended into St. Paul, Minnesota, in 1959. A new, five-story Dayton's, occupying an entire downtown St. Paul city block, was completed in 1963. Dayton Development Company opened Brookdale shopping center in 1962 in a northern suburb of Minneapolis, and is expanding this complex with the addition of a Dayton's store in 1966. ■ The Company entered the discount merchandising field in 1962 with Target Stores, Inc., which now has five stores in operation with the sixth and seventh stores scheduled to open in 1966. ■

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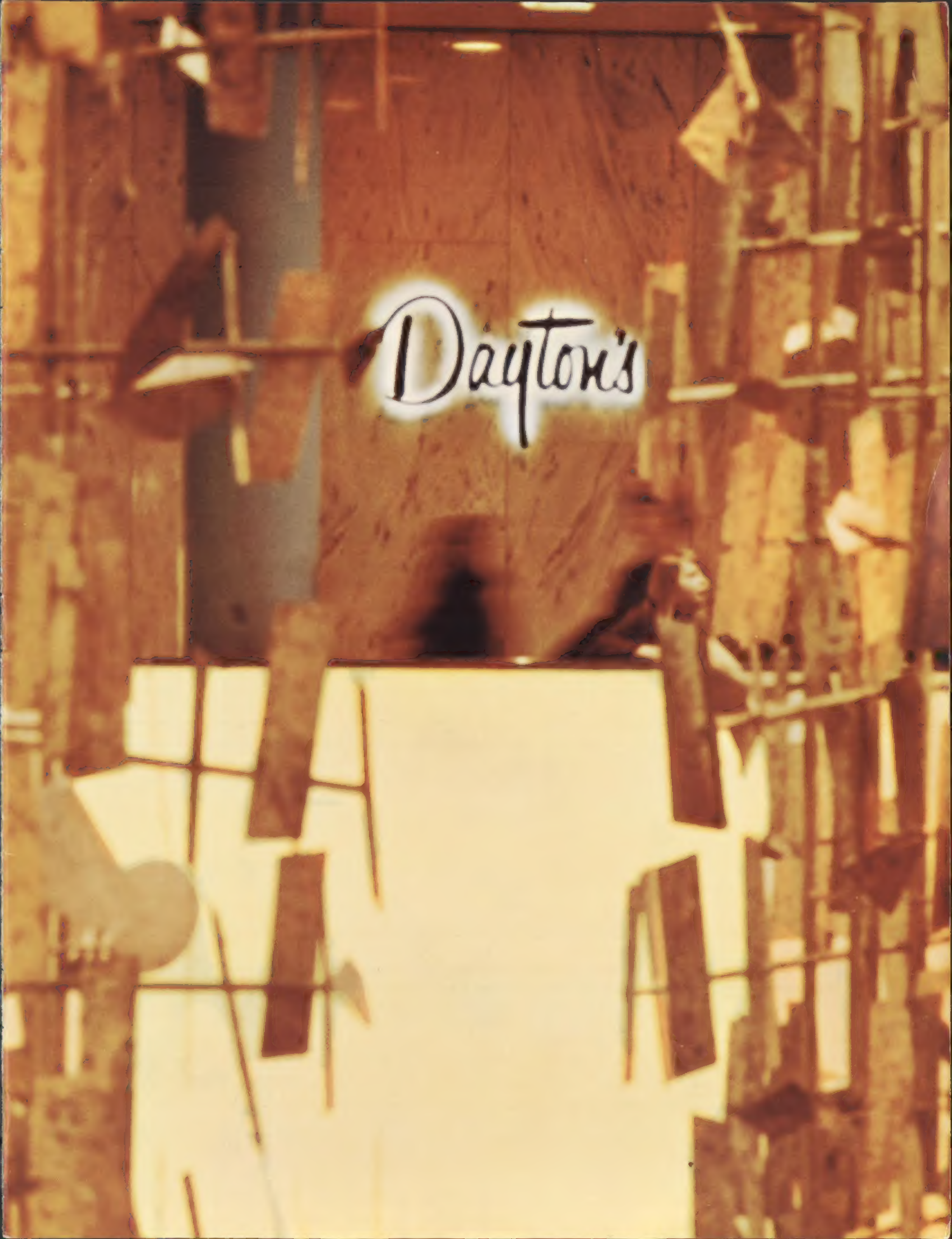

Dayton's

To the people we serve

The projected growth of The Dayton Company requires that it expand beyond the concept of a privately-owned operation. To this end, we are issuing our first public Annual Report. We arrived at the decision to make our figures public after much deliberation. However, we feel disclosure will further growth possibilities, open expansion opportunities, and give our management the challenge of operating in an atmosphere of public scrutiny. It is our intention to report our results annually.

Sales of the Company's retail operations totaled $186,166,671 during the fiscal year ended January 29, 1966. This was an increase of 14 percent over sales of $162,773,739 in the previous year. Net income was $7,128,981 compared with $5,435,205 in the preceding fiscal year ended January 30, 1965 — a 31 percent gain.

Gains in each of our retail outlets contributed to this record, with the most significant increases coming from Dayton's, Minneapolis, and from Target Stores, Inc. The potential of Target is demonstrated by gains of 44 percent in sales and 100 percent in pre-tax profits in 1965 over the previous year. At the same time, the downtown Minneapolis store had the largest dollar increase in sales of any retail unit in The Dayton Company.

To increase our share of the market in the area we serve, Target opened a discount store in Bloomington, a southern suburb of Minneapolis, during 1965. This brought the total number of Target stores to five. Two more Target units are scheduled to be opened in Denver, Colorado, in the Fall of 1966, marking our first venture outside the Upper Midwest. We believe the success of Target in the heavily-competitive Minneapolis-St. Paul metropolitan area, where its stores now dominate the discount field, provides an operational format which can do as well in other areas of the country.

Another Dayton's store with 195,000 square feet of area, will open during the Summer of 1966 in Brookdale. This shopping center, north of Minneapolis in Brooklyn Center, is now in its Stage II expansion which will see a doubling of space to 857,000 square feet in 1966. Like Southdale, our first shopping center, Brookdale dominates retail merchandising in a large, rapidly growing suburban area.

From its opening in 1956, Southdale shopping center has become the nucleus of the surrounding community through the efforts of Dayton Development Company. This last year saw the realization of major portions of this plan with completion of the 210-bed Fairview Southdale Hospital, construction of a 65,000 square-foot second wing to the Medical Building, and opening of 310 units in The Colony apartment-town house complex.

There were other significant developments in 1965. Land was purchased for a third shopping center to be opened in 1971 in an area west of Minneapolis. Wabasha Court, a 74,000-square-foot retail center opened in St. Paul. The Dayton Credit Company, a wholly-owned subsidiary, was formed to finance receivables of Dayton's and thus provide an added source of financing for long-range growth.

Being closely wedded to the communities in which we operate, The Dayton Company has continually striven to fulfill its obligation of citizenship. This stems both from a deep-seated conviction of corporate responsibility and from an awareness that we have much to gain from the area we serve. In this context, The Dayton Company has consistently, over the years, contributed five percent of income before taxes to charity. We anticipate continuing this practice in the years ahead.

We expect retail sales to continue strong in 1966, despite the imponderables of the war in Viet Nam and the increasing evidence of inflationary tendencies. This would reflect the growth of consumer disposable income, high employment, and continuing confidence in the economy. Retailing also should benefit from the large numbers of new families being formed; from an anticipated increase in the buying power of young people, and, in Minnesota, from the financial and cultural vitality of the Twin Cities of Minneapolis and St. Paul. The evolving shift in agriculture — the major industry of the Upper Midwest — from a surplus position to one in which it is coping with world food shortages also will be a major factor in the growing prosperity and buying power of consumers in this region.

A great measure of the credit for our growth in the past year must go to our loyal customers and to our dedicated employees. They have made possible the results that we set forth in this report.

Donald C. Dayton — Bruce B Dayton

DONALD C. DAYTON
Chairman of the Board

BRUCE B. DAYTON
President

Accent on youth — teen fashions with a beat

You can get it at Dayton's

Shopping at Dayton's always is an exciting adventure. Dayton's stores are known for quality, innovation and excitement — places where the public finds new trends, new fashions, new modes of living.

Underlying this dynamic merchandising concept is a policy of integrity and reliability in dealing with customers who, in more than three-score years, have come to depend upon Dayton's for service and honest value. Attesting to this are the 425,000 Upper Midwest residents who carry Dayton's shopping cards.

With five stores totaling 2,127,000 square feet of area, Dayton's, Business Week magazine stated, "sets and maintains the trends in perhaps the country's largest geographical trading area from western Wisconsin to eastern Montana."

The years have seen the establishment of the Oval Room, which carries many top exclusive couture lines; J. B. Hudson's, a distinctive jeweler; Gallery 12, which sells Picasso, Miro and Braque and, in the past year, a series of shops — two are Granny's Attic and the John Stephen shop for sophisticated young fashions. These appeal to an ever increasing number of discriminating consumers. At the other end of the spectrum are downstairs stores meeting the needs of a variety of incomes and tastes in a wide-spread community. There's just about anything the public wants: From a myriad of items under a dollar to a Norman Norell gown for $2,750, a diamond solitaire for $11,000 — or a Wooly monkey from South America for $150.

Shopping, Dayton's believes, should be made easy and this is done through three different easy payment plans, 24-hour-a-day telephone order board, mail order department and delivery service. Parking ramps with space for 825 cars in Minneapolis and 675 in St. Paul are coupled to the stores for the customer's convenience. At the Customer Service Center in the Minneapolis store you can buy a hearing aid, add to your coin collection, have your electric shaver repaired, or get a prescription filled. Catering to cultural and leisure time pursuits, the Center offers the services of a travel agency and a ticket agency, which last year sold 460,000 tickets to events ranging from Vikings football games to Minneapolis Symphony concerts.

Steuben Glass . . . at J. B. Hudson, Jeweler, and only 19 other stores in this country

"Bulls Eye" bargains for hundreds of thousands

Implementing its merchandising policy of trend setting and innovation is a promotional approach utilizing show business techniques to set a mood of excitement throughout the stores. To accelerate this approach, Dayton's opened a 12,000 square foot auditorium in 1963, the country's largest in a department store. There, last year, 700,000 people visited special events such as an English Garden flower show, circus, the Mexican Fiesta, European Import Fair, Santaland, and Saturday teen dances.

Much of this merchandising approach today is directed at youth, an important, rapidly growing segment of the buying public. A month-long "Youthquake" last August featured appearances by the young English designers, Cash, Quant, McCann. Entertainers, including the Remo 4 rock band from Liverpool and Gary Lewis and the Playboys delighted 20,000 teenagers. Dayton's downtown Minneapolis store introduced London "mod" fashions to the United States.

Carnaby Street comes to Dayton's, Minneapolis, U.S.A., first

Although its merchandising is broadly directed at the Upper Midwest, the focus is the Minneapolis-St. Paul metropolitan area. This is the fourteenth largest market in the country, but the fourth in sales per household of general merchandise, according to Minneapolis Star and Tribune Market Facts. Reflected here is not only the better-than-average buying power per household but also the heavy influx of non-resident shoppers from the surrounding five states — an area of 336,000 square miles and twelve million people.

Dayton's still firmly believes in downtown as demonstrated by construction of the new St. Paul store, the first major department store built in the city's downtown area in over fifty years. The first integrated shopping and parking structure of its kind, Dayton's St. Paul has 388,000 square feet of store space and 242,000 square feet of ramp space.

Happy "13-Teener" takes her charm school graduation walk

A significant indication of central business district vitality is the continued sales leadership of the Minneapolis store as measured against all other company operations.

TARGET STORES, INC.

Target Stores, Inc., was conceived with the knowledge that, while there always will be room for full-service, quality department stores at the upper end of the merchandising scale, there also will be people who wish to take advantage of low margins and convenience shopping through the economies of mass merchandising.

Since the first Target store was opened early in 1962 in Roseville, a suburb north of St. Paul, its identification as a quality discount operation has been firmly established. There are now five Target stores, with four situated in the Minneapolis-St. Paul metropolitan area and one in Duluth.

A recent Minneapolis Star and Tribune survey of shopping habits in the city's suburbs ("Retail Revolution 1955-1965") discloses that 51 percent of women customers in Hennepin County shopped at a Target store in 1965. The survey stated: "When shopping at specific centers is considered, the most significant change is the emergence of Target as the leader."

Target management considers a number of factors to be essential to successful operation. These include domination of the market in the number and quality of products available; merchandising techniques which provide excitement in shopping; selection of prime traffic locations, and an outstanding food operation.

Only 11 percent of sales in Target stores are from leased departments. This does not include sales of the grocery departments, operated by Applebaum's.

The five Target stores in Minnesota maintain a separate identity within The Dayton Company. Target has its own

management staff, its own buying organization, and freely competes for customers and employees.

Two Target stores are to be opened in Denver, Colorado, in 1966, in accordance with plans to expand into other metropolitan areas which offer potential similar to that of the Twin Cities and Duluth.

The Northbriar Shop,
Ivy League for the Upper Midwest

DAYTON DEVELOPMENT COMPANY

This division has as its principal purpose the ownership and operation of shopping centers and the development of adjacent land. Its major holdings are Southdale and Brookdale shopping centers.

When Southdale was opened in 1956, it was called by Life Magazine "The world's largest shopping area under one roof" and "The splashiest shopping center in the U.S." Innovations were air-conditioned "springtime shopping year around" and next to Dayton's 258,000 square-foot store, the inclusion of its largest competitor, Donaldson's.

Now the center of a completely integrated community including office buildings, a hospital and medical center, and residential areas, Southdale contains 70 shops and services and two department stores in a space of 972,000 square feet.

Construction is on schedule for a 400,000 square-foot addition to Brookdale. This Stage II development includes a Dayton's store of 195,000 square feet, expansion of Penney's to make it a complete department store, and a number of

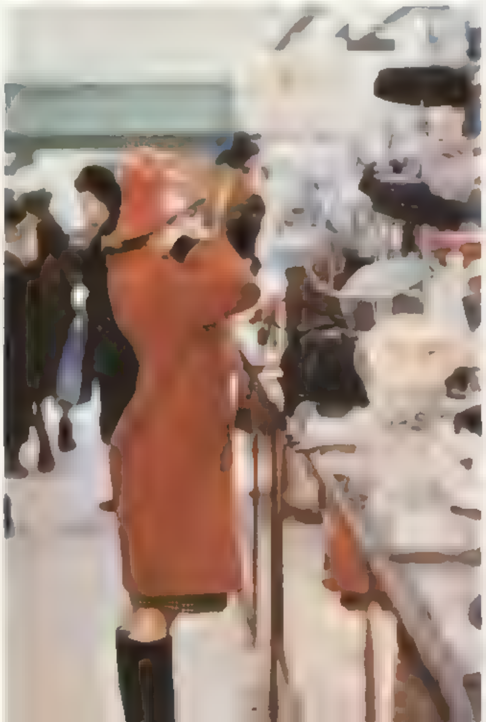
Furnishing your home at Dayton's is exciting

smaller shops. With its present Sears store, Brookdale will become the first shopping center in the Upper Midwest with three major department stores. The expansion will double the size of Brookdale to 857,000 square feet of 53 stores and services on a 71-acre area.

During 1965, acquisition of 180 acres of land for a third shopping center in the western suburban area of Minneapolis was completed, and the Wabasha Court retail center was opened in St. Paul.

Customer satisfaction
is finding what you want

Teen dances, festivals, fairs, circuses, elaborate garden shows, all in Dayton's Auditorium in Minneapolis

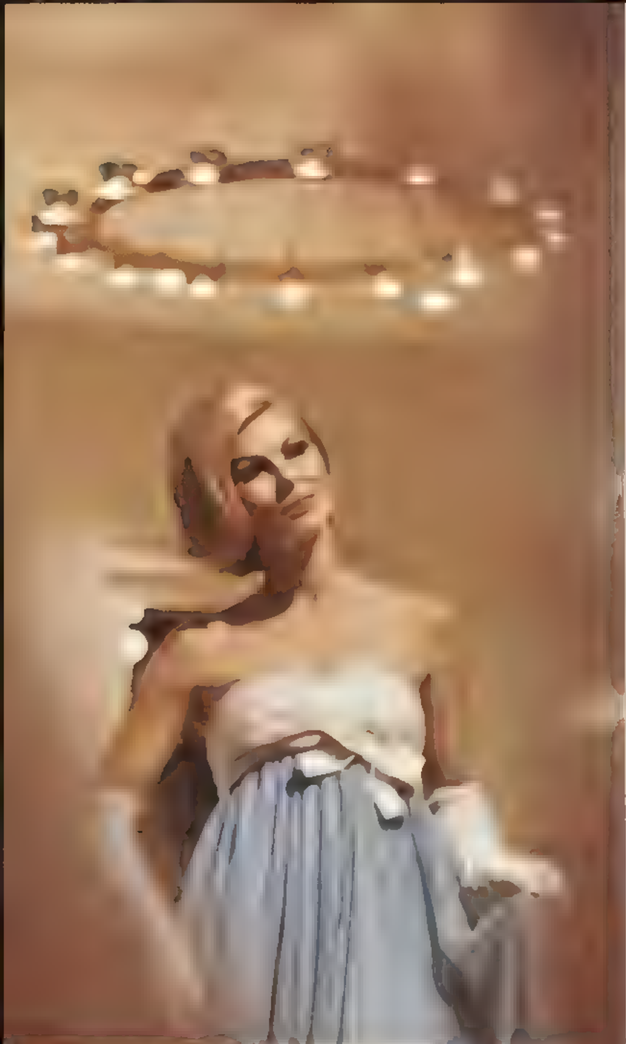


Within the past ten years, Dayton Development Company has constructed 1,806,194 square feet of shopping and office space on 160 acres. With an additional 355 acres of land available for commercial use, the Company is accelerating its program for developing and thus enhancing the value of these properties.

Eighth Street Development Company, a wholly owned subsidiary of The Dayton Company, owns and operates downtown properties related to the department store operations of Dayton's.

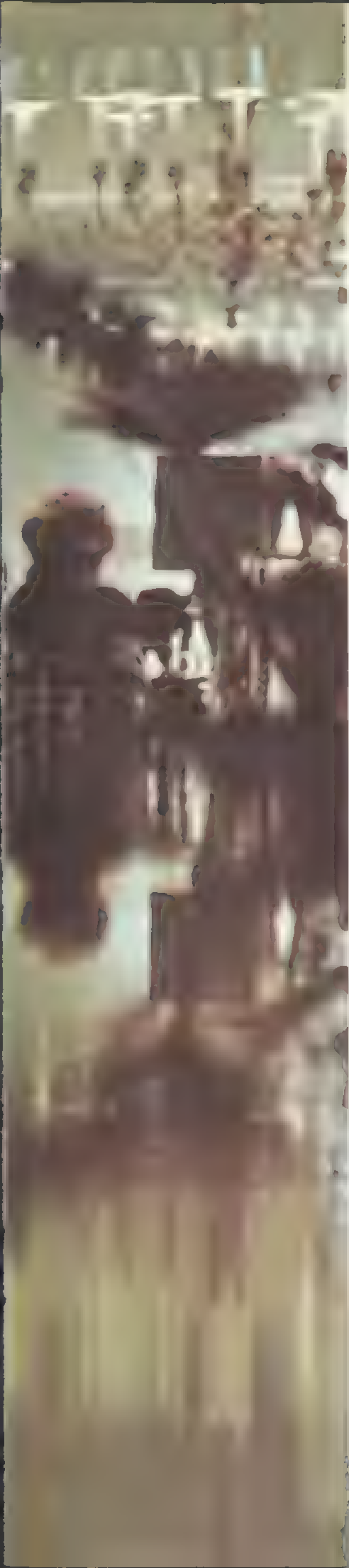
EXECUTIVE CHANGES

To keep pace with expansion of operations and to strengthen the management organization, Donald C. Dayton, President of The Dayton Company, was elected



Dayton's Oval Room — exclusive couture fashions

Convenience shopping, Target style



The doors of Dayton's in Southdale — invitation to a world of fine merchandise

Chairman of the Board early in 1965. This election filled the position of Chairman for the first time.

In other changes made at the same time, Bruce B. Dayton was elected President of The Dayton Company; Kenneth N. Dayton was elected Executive Vice President and General Manager of Dayton's, and Stuart W. Wells, Jr., was elected Vice President for Merchandising and Publicity.

Seeking an ever closer relationship with the people and governments in the Twin Cities and suburban area, The Dayton Company created the position of Vice President in charge of Community Relations. Wayne E. Thompson, former City Manager of Oakland, California, was elected to this post in September, 1965.

DATA PROCESSING EXTENDED

The Dayton Company is in the forefront of the department store field in utilizing electronic data processing in its operation. Employing two NCR 304 computers, the Company is working toward new applications for increasing profitability by improving merchandising, research and decision-making techniques.

An IBM 360 Computer is being installed in Target's Minneapolis suburban headquarters to implement advanced merchandising techniques, and to handle payroll, sales, expense and inventory statistics.

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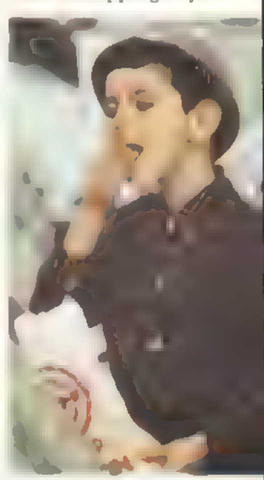
With approximately 8,200 employees, The Dayton Company is Minnesota's fourth largest employer.

The Company is providing opportunity through expansion and management training. An intensive recruiting effort seeks persons of executive caliber for management functions and outstanding talent for development of creative merchandising activities.

An indicator of the Company's interest in progressive growth is the amount of training offered and conducted for employees at all levels: all key executives attend management schools: The Dayton Company joined with Honeywell, General Mills, and Northwest Bancorporation to found a management school, now in its eighth year; more than 200 persons are enrolled each year in middle management seminars; a training program is conducted annually for approximately 70 college students.

One measure of a company's stability is the proportion of its employees with long service. In its department stores, Dayton's has 1,535 employees with more than 10 years of service and 198 persons who have worked for Dayton's more than 25 years. In addition, there are 954 retired employees who are benefitting from pension plans.

Popcorn at Target where shopping is fun



Financial Review

SALES

Net sales of The Dayton Company and retail subsidiaries during the fiscal year ended January 29, 1966, were $186,166,671, the largest in the Company's history. This total was 14 percent larger than the $162,773,739 sales volume in the preceding year.

EARNINGS

Net earnings reached $7,128,981, an increase of $1,693,776 or 31 percent over the 1964 earnings of $5,435,205. Net operating profits in both retail divisions grew significantly as a result of increased sales volume, accompanied by improved margins and effective control over expenses. Pre-tax earnings increased by 48 percent from 1964. The percentage increase in after-tax earnings was somewhat less because of a substantial loss carry-forward available to Target Stores, Inc., in 1964. A factor in the 1965 earnings figures was a reduction in repair and maintenance expenses of approximately $1,130,000 from the 1964 level.

Earnings per common share were $1.99 during fiscal 1965, after adjustments were made to reflect the stock split and stock dividend. Restated on the same basis, 1964 earnings per share were $1.41. The increase was 41 percent.

CAPITAL STRUCTURE

Shareholders' equity increased by $5,778,309 from $49,997,553 to $55,775,862 after payments of $809,603 in preferred dividends. Effective March 2, 1966, the number of authorized common shares was increased from 200,000 to 4,000,000 and a 10 for 1 stock split was authorized. This was followed by a 100 percent stock dividend, resulting in an increase of the number of common shares issued and outstanding to 3,165,500.

In furtherance of the Company's policy to reduce the amount of preferred stock outstanding, a call for tenders was issued in December, 1965, to the holders of 6 percent First Preferred Stock, Series A and B, which resulted in the purchase of 6,154 shares, par value of $100 per share, on February 6, 1966. Previously, during 1965, 2,030 preferred shares had been redeemed.

Long term debt was reduced from $16,632,534 to $15,724,960.

CAPITAL EXPENDITURES AND WORKING CAPITAL

Capital expenditures for Dayton's and Target of $3,400,000 were substantially below the level of recent years. Coupled with the sharp earnings rise and the substantial depreciation charges, this resulted in a net working capital increase of $4,805,997. The ratio of current assets to current liabilities increased to 2.2 from 1.9.

For the year 1966, more than $9,000,000 is programmed for capital improvements.

DAYTON DEVELOPMENT COMPANY AND EIGHTH STREET DEVELOPMENT COMPANY

The two real estate subsidiaries made significant gains during the year. Total rental from operating properties increased 12 percent to $4,409,386. Operating income for these properties amounted to $2,267,845 before interest and depreciation. Book value of properties owned by Dayton Development Company and Eighth Street Development Company was $36,443,324 at the end of 1965.

The continued development of real estate operations calls for projected capital expenditures of $5,000,000 for 1966 compared to $6,500,000 in 1965.

Combined with the previously noted expenditures for retail expansion, total capital spending for The Dayton Company and all subsidiaries during 1966 is expected to exceed $14,000,000.

DAYTON CREDIT COMPANY

In the latter part of 1965, Dayton Credit Company was formed to finance the expanding installment credit sales and resultant accounts receivables of Dayton's. In January, 1966, Dayton's sold $2,800,000 in receivables to the Credit Company. Dayton Credit Company initially will use bank lines of credit to supplement the initial equity capital of $775,000.

BROOKDALE SHOPPING CENTER BROOKLYN CENTER, MINNESOTA 1962
WABASHA COURT, ST. PAUL, MINNESOTA 1965
DAYTON-RADISSON RAMP, MINNEAPOLIS, MINNESOTA 1959
SOUTHDALE SHOPPING CENTER, EDINA, MINNESOTA 1956
DAYTON DEVELOPMENT COMPANY 1952
THE DAYTON COMPANY
EIGHTH STREET DEVELOPMENT CO. 1927
DAYTON CREDIT COMPANY 1965
TARGET STORES, INC. 1962
ROSEVILLE, MINNESOTA 1962
CRYSTAL, MINNESOTA 1962
DULUTH, MINNESOTA 1962
KNOLLWOOD, ST. LOUIS PARK MINNESOTA 1962
BLOOMINGTON, MINNESOTA 1965
DENVER, COLORADO 1966
DENVER, COLORADO 1966
DAYTON'S STORES
DAYTON'S, ROCHESTER 1954
FANTLE'S, SIOUX FALLS 1955
DAYTON'S, SOUTHDALE 1956
DAYTON'S, ST. PAUL 1963
DAYTON'S, BROOKDALE 1966

Balance Sheet

ASSETS	January 29, 1966	January 30, 1965
CURRENT ASSETS		
Cash	$ 4,004,389	$ 3,788,989
Accounts receivable, less allowance $386,598 — 1966; $334,335 — 1965	24,765,744	24,897,786
Merchandise inventories — Note B	27,770,196	24,523,370
Supplies and prepaid expenses	386,353	275,864
TOTAL CURRENT ASSETS	$56,926,682	$53,486,009
INVESTMENTS AND OTHER ASSETS		
Investment in and advances to subsidiaries — Note A	$ 9,955,161	$ 9,187,497
Marketable securities — at cost (market prices $3,667,828 — 1966; $2,773,822 — 1965)	1,379,171	919,469
Other accounts	1,111,883	987,371
	$12,446,215	$11,094,337
PROPERTY AND EQUIPMENT — at cost — Note C		
Land, buildings and equipment	$50,892,870	$49,200,018
Less allowances for depreciation — Note A	20,633,209	18,120,050
	$30,259,661	$31,079,968
	$99,632,558	$95,660,314

LIABILITIES AND SHAREHOLDERS' INVESTMENT	January 29, 1966	January 30, 1965
CURRENT LIABILITIES		
Notes payable to bank — unsecured	$ —	$ 7,050,000
Accounts payable and accrued liabilities	17,593,850	15,097,824
Income taxes, including deferred on income reported on the installment basis	7,405,693	4,153,570
Long-term debt due within one year	875,282	938,755
TOTAL CURRENT LIABILITIES	$25,874,825	$27,240,149
DEFERRED CREDITS, including deferred income taxes $1,714,393 — 1966; $1,399,654 — 1965 — Note A	2,256,911	1,790,078
LONG-TERM DEBT — due after one year — Note C	15,724,960	16,632,534
SHAREHOLDERS' INVESTMENT		
Preferred Stock — Note D	$14,925,100	$15,128,100
Common Stock, par value $1 a share — Note F: Authorized 4,000,000 shares, issued 1,717,000 shares less those in treasury — 134,250 shares 1966; 92,250 shares 1965	1,582,750	1,624,750
Retained earnings — Notes A and C	39,268,012	33,244,703
	$55,775,862	$49,997,553
	$99,632,558	$95,660,314

See notes to financial statements.

Statement of Income

	Fiscal Year Ended January 29, 1966	Fiscal Year Ended January 30, 1965
Net retail sales, including sales of leased departments	$186,166,671	$162,773,739
Deduct:		
Cost of sales and expenses exclusive of items listed below	$160,514,978	$141,235,897
Maintenance and repairs	763,572	1,894,037
Depreciation and amortization	2,723,071	2,601,211
Rentals	2,088,720	1,972,450
Interest	1,154,153	1,292,267
Taxes other than taxes on income	3,745,154	3,512,031
Pensions to retired employees and contribution to retirement plan	943,042	648,932
	$171,932,690	$153,156,825
OPERATING INCOME	$ 14,233,981	$ 9,616,914
Taxes on income — Note A	7,105,000	4,181,709
NET INCOME	$ 7,128,981	$ 5,435,205

See notes to financial statements.

Statement of Retained Earnings

	Fiscal Year Ended January 29, 1966	Fiscal Year Ended January 30, 1965
Balance at beginning of year — Note A	$33,244,703	$28,749,100
Add net income for the year	7,128,981	5,435,205
	$40,373,684	$34,184,305
Deductions:		
Cash dividends on Preferred Stock	$ 809,603	$ 823,512
Cash dividend on Common Stock	39,569	—
Excess of cost over par value of Common Stock acquired for treasury	256,500	116,090
	$ 1,105,672	$ 939,602
Balance at end of year	$39,268,012	$33,244,703

Statement of Source and Application of Funds

	Fiscal Year Ended January 29, 1966	Fiscal Year Ended January 30, 1965
Source of funds:		
Net income for year	$ 7,128,981	$5,435,205
Depreciation	2,723,071	2,601,211
Other	525,228	622,491
	$10,377,280	$8,658,907
Application of funds:		
Dividends	$ 849,172	$ 823,512
Property and equipment — net	1,902,764	3,124,005
Decrease in long-term debt	907,574	906,916
Other	1,911,773	1,337,281
Increase in working capital	4,805,997	2,467,193
	$10,377,280	$8,658,907

See notes to financial statements.

Notes to Financial Statements

January 29, 1966

NOTE A

Principles of Consolidation and Other Accounting Policies

The consolidated financial statements include the accounts of the Company and its retail subsidiaries, all of which are wholly-owned. The accounts of wholly-owned (except for $1,695,500 of outstanding preferred shares) real estate and finance company subsidiaries are not consolidated and the investment therein is carried at cost. See separate financial statements of these companies elsewhere in this report.

The Company has changed its method of accounting for depreciation for financial purposes from accelerated to straight-line methods while continuing accelerated methods for income tax purposes. This change has been reflected retroactively in the financial statements and as a result $1,399,654 of income taxes at January 30, 1965 previously reported as a current liability have been reclassified as deferred; retained earnings at February 1, 1964 have been increased by $938,934 and net income for the year ended January 30, 1965 has been increased by $406,783.

Deferred taxes on income reported on the installment basis have been classified as a current liability.

The income tax provision includes $749,739 — 1966 and $496,481 — 1965 of deferred income taxes. The investment credit has been used to reduce income taxes for the year.

Cost of sales, buying and occupancy expenses were $139,686,954 — 1966 and $123,584,592 — 1965. Selling, general and administrative expenses were $31,256,511 — 1966 and $28,508,046 — 1965.

NOTE B

Merchandise Inventories

Substantially all merchandise inventories on hand and in transit are priced at cost under the retail method on the last-in, first-out basis. Inventories are stated at $664,219 — 1966 and $431,573 — 1965, less than the amount which would have been determined under the retail inventory method without regard to last-in, first-out principles.

NOTE C

Long-Term Debt

(1) Sinking Fund Notes — $13,600,000

The 5⅜% sinking fund notes mature $800,000 annually on each January 31st from 1965 through 1981 and the balance is payable January 31, 1982. The sinking fund note agreements contain requirements and limitations relating to sale of receivables, working capital, dividends and other restricted payments.

(2) Mortgage Notes — $2,124,960

Land, land improvements, buildings and fixtures and equipment carried in the accounts at a cost of $4,472,181 are pledged as collateral to the 6¼% mortgage notes payable, due $52,764 (including interest) quarterly. The mortgages and related loan agreements contain requirements and limitations relating to working capital, dividends and other restricted payments of a wholly-owned consolidated subsidiary.

NOTE D

PREFERRED STOCK

	1966	1965
First Preferred — Series A, 6% cumulative, par value $100 a share, redeemable at par and unpaid dividends:		
Authorized 45,000 shares; issued 41,830 shares less those in treasury — 5,949 shares 1966, 5,419 shares 1965	$ 3,588,100	$ 3,641,100
First Preferred — Series B, 6% cumulative, par value $100 a share:		
Authorized 26,000 shares; issued 25,971 shares less those in treasury — 2,188 shares 1966, 1,488 shares 1965	2,378,300	2,448,300
Second Preferred — Series A, 4½% cumulative, par value $100 a share, redeemable at par and unpaid dividends:		
Authorized and issued 35,385 shares less those in treasury — 1,500 shares 1966, 1,000 shares 1965	3,388,500	3,438,500
Second Preferred — Series B, 4½% cumulative, par value $100 a share, redeemable at par and unpaid dividends:		
Authorized and issued 7,082 shares less 465 shares in treasury	661,700	661,700
Third Preferred, 5% cumulative, par value $100 a share, redeemable at par and unpaid dividends:		
Authorized and issued 51,510 shares less those in treasury — 2,425 shares 1966, 2,125 shares 1965	4,908,500	4,938,500
Total	$14,925,100	$15,128,100

First Preferred Stock — Series B is redeemable at $114 a share and unpaid dividends to February 5, 1966, and for $1.00 less each year until February 5, 1979, and at $100 and unpaid dividends thereafter. The Company has the option to purchase at $112 a share and unpaid dividends, any shares sold or presented for transfer prior to February 5, 1967.

NOTE E

LEASES

Long-term leases at January 29, 1966 require aggregate minimum annual rentals of approximately $1,564,220, of which $626,683 is payable to unconsolidated subsidiaries. Most of these leases require the payment of real estate taxes and other expenses and, in certain instances, increased amounts based on percentage of sales.

NOTE F

SUBSEQUENT EVENTS

New stores:

The Company and its subsidiaries have commitments in the amount of approximately $3,750,000 for additional facilities.

Stock split:

At the annual meeting of the shareholders in February 1966 action was taken to split the Common Shares of the Company on a ten-for-one basis. Retroactive effect has been given to this change in the statement of financial position at January 29, 1966 and January 30, 1965. In February 1966 the Company declared a stock dividend of one share of Common Stock for each share outstanding after the stock split. This resulted in a transfer of $1,535,500 from retained earnings to Common Stock in March 1966.

Tender:

The Company issued a tender for the 6% First Preferred Stock, Series A and B, at $100 a share and redeemed 6,154 of such shares on February 6, 1966.

DAYTON DEVELOPMENT COMPANY

Balance Sheet

ASSETS	January 29, 1966	January 31, 1965
Cash	$ 225,442	$ 227,987
Accounts receivable	508,806	565,235
Deferred leasing and other costs, less amortization	1,183,022	1,154,611
Mortgage notes receivable ($369,059 — 1965) and sundry accounts	13,188	380,209
Note receivable from affiliated company	515,000	—
Properties — on the basis of cost — Note A:		
Land	$ 9,890,344	$ 8,767,742
Buildings and equipment	25,135,063	20,478,993
Less allowance for depreciation — Note B	(5,462,339)	(4,642,050)
	$29,563,068	$24,604,685
	$32,008,526	$26,932,727

LIABILITIES		
Accounts payable and accrued liabilities	$ 2,009,485	$ 1,344,967
Notes and contracts — Note A	21,127,542	16,224,379
Advances from parent company	—	2,832,035
	$23,137,027	$20,401,381
Deferred income taxes	29,460	15,575
SHAREHOLDERS' INVESTMENT		
Preferred Shares, 5% cumulative, par value $100 a share, authorized 17,000 shares, issued and outstanding 16,955 shares	$ 1,695,500	$ 1,695,500
Common Shares, par value $10 a share, authorized, issued and outstanding 150,000 shares	1,500,000	1,500,000
Additional paid-in capital ($2,397,983 contributed by parent company in current year)	5,896,857	3,498,875
Retained-earnings deficit (deduction)	(250,318)	(178,604)
	$ 8,842,039	$ 6,515,771
	$32,008,526	$26,932,727

See notes to financial statements.

DAYTON DEVELOPMENT COMPANY

Statement of Income and Retained-Earnings Deficit

	Year Ended January 31, 1966	Year Ended January 29, 1965
Rentals earned ($3,073,000 — 1966; $2,696,129 — 1965) and other operating revenue	$ 3,366,425	$ 2,978,025
Miscellaneous including gain on sale of properties ($424,711 — 1966; $116,017 — 1965)	435,645	130,779
	$ 3,802,070	$ 3,108,804
Operating expenses	$ 2,023,131	$ 1,500,620
Interest expense	796,918	680,701
Provision for depreciation ($794,283 — 1966; $721,243 — 1965) and amortization — Note B	955,013	896,943
	$ 3,775,062	$ 3,078,264
INCOME BEFORE TAXES THEREON	$ 27,008	$ 30,540
Provision for deferred income taxes	13,884	15,575
NET INCOME	$ 13,124	$ 14,965
Retained-earnings deficit at beginning of year — Note B	178,604	108,794
	$ 165,480	$ 93,829
Dividends on Preferred Stock	84,838	84,775
RETAINED-EARNINGS DEFICIT AT END OF YEAR	$ 250,318	$ 178,604

See notes to financial statements.

DAYTON DEVELOPMENT COMPANY

Notes to Financial Statements

January 29, 1966

NOTE A

NOTES AND CONTRACTS

Notes and contracts consist of a $250,000 5% demand note payable to the parent, interim financing of $3,200,000, contracts for deed of $3,281,867 and mortgage notes aggregating $14,395,675.

The contracts and mortgage notes bear interest at rates from 4¼% to 6½% and are payable over periods ranging from 11 to 22 years from inception. Aggregate annual payments through January 1971, including interest where it is a part of required monthly payments, are as follows: 1967 – $1,852,946; 1968 – $1,887,586; 1969 – $1,883,984; 1970 – $1,578,701; 1971 – $1,578,701.

The net carrying amount of land, buildings and equipment pledged as collateral to the mortgage notes aggregates $18,141,019.

The interim financing is for new construction. Upon completion and acceptance of the building, permanent long-term financing is to be provided by a first mortgage note in the amount of $7,500,000 at 5⅞%, payable in monthly installments of $50,000.

NOTE B

ACCOUNTING POLICIES

The Company has changed its method of accounting for depreciation for financial purposes from accelerated to straight line methods while continuing accelerated methods for income tax purposes. This change has been reflected retroactively in the financial statements and as a result retained-earnings deficit at February 1, 1964 has been decreased by $12,[illegible]5 and net income for the year ended January 31, 1965 has been increased by $23,890. For the year ended January 31, 1965 a $10,356 loss on liquidation of a subsidiary previously charged to retained earnings has been included in expenses.

The Company has changed its reporting period from a fiscal year ending January 31st to one ending the Saturday nearest the last day of January.

EIGHTH STREET DEVELOPMENT COMPANY

Balance Sheet

	January 29, 1966	December 31, 1964
ASSETS		
Cash	$ 64,872	$ 122,606
Accounts receivable and sundry (includes $213,157 — 1966; $136,427 — 1964 due from parent company)	264,576	327,142
Properties — on the basis of cost — Note A:		
Land	$ 2,875,862	$ 2,023,081
Buildings	5,105,589	4,674,475
Less allowances for depreciation — Note B	(1,101,195)	(913,225)
	$ 6,880,256	$ 5,784,331
	$ 7,209,704	$ 6,234,079
LIABILITIES		
Accounts payable and accrued liabilities	$ 328,522	$ 242,227
Income taxes	—	40,323
Notes and contracts — Note A	4,761,533	3,905,921
Advances from parent company	—	1,358,337
	$ 5,090,055	$ 5,546,808
Deferred income taxes — Note B	245,309	208,828
SHAREHOLDERS' INVESTMENT		
Capital Stock, par value $100 a share, authorized 3,000 shares, issued and outstanding 435.15 shares	$ 43,515	$ 43,515
Additional paid-in capital ($1,364,288 contributed by parent company in current year)	1,596,649	232,361
Retained earnings	234,176	202,567
	$ 1,874,340	$ 478,443
	$ 7,209,704	$ 6,234,079

See notes to financial statements.

EIGHTH STREET DEVELOPMENT COMPANY

Statement of Income and Retained Earnings

	Period of 13 Months Ended January 29, 1966	Year Ended December 31, 1964
Rentals earned (including $467,125 — 1966; $442,468 — 1964 from parent)	$ 1,042,961	$ 947,824
Operating expenses	$ 554,055	$ 431,043
Other deductions net of other income (interest expense $240,423 — 1966; $218,046 — 1964)	236,429	217,297
Provision for depreciation — Note B	187,969	163,712
	$ 978,453	$ 812,052
INCOME BEFORE TAXES THEREON	$ 64,508	$ 135,772
Provision for income taxes — Note B	32,899	69,244
NET INCOME	$ 31,609	$ 66,528
Retained earnings at beginning of period — Note B	202,567	136,039
RETAINED EARNINGS AT END OF PERIOD	$ 234,176	$ 202,567

See notes to financial statements.

EIGHTH STREET DEVELOPMENT COMPANY
Notes to Financial Statements

January 29, 1966

NOTE A

NOTES AND CONTRACTS

Notes and contracts consist of a \$515,000 5½% demand note payable to an affiliate, contracts for deed of \$519,215, and mortgage notes aggregating \$3,727,318.

The contracts and mortgage notes bear interest at 4½ to 6¼% and are payable over periods from 4 to 25 years from inception. Aggregate annual payments through January 1971, including interest where it is a part of required monthly payments, are as follows: 1967 – \$662,881; 1968 – \$435,149; 1969 – \$421,489; 1970 – \$415,489; 1971 – \$341,936.

The net carrying amount of land and buildings pledged to secure payment of the mortgage notes aggregates \$4,826,573.

NOTE B

ACCOUNTING POLICIES

Due to the filing of a consolidated federal tax return by its parent for the year ended January 30, 1965, the Company was required to file a federal income tax return for the month of January 1964 and pay \$40,323 of additional income taxes. Since this taxable income had previously been reported for financial purposes, the additional income taxes have been retroactively charged to retained earnings. Results of operations for 1964 have been restated to provide for income taxes because the filing of the short-period federal income return exhausted income tax loss carryovers.

The Company has changed its method of accounting for depreciation for financial purposes from accelerated to straight line methods while continuing accelerated methods for income tax purposes. This change has been reflected retroactively in the financial statements and as a result retained earnings at December 31, 1963 have been increased by \$159,978 and net income for the year ended December 31, 1964 has been increased by \$40,661.

The income tax provision includes \$36,481 – 1965 and \$42,320 – 1964 of deferred income taxes.

The Company has changed its reporting period from a calendar year to a year ending the Saturday nearest the last day of January.

NOTE C

LONG-TERM LEASES

In connection with a parking ramp the Company is obligated for rental at \$63,500 per annum until July 1, 1968 and thereafter until July 1, 1998 at 5% of the value of the leased land. As additional rent, the Company is obligated to pay real estate taxes levied against the property.

DAYTON CREDIT COMPANY
Balance Sheet

January 29, 1966

ASSETS		
Cash		\$ 35,048
Accounts receivable: Installment accounts, less allowance \$39,300	\$ 2,656,794	
Due from parent company	185,998	2,842,792
Unamortized premium		82,860
		\$ 2,960,700
LIABILITIES AND SHAREHOLDER'S INVESTMENT		
Notes payable to banks — unsecured		\$ 2,225,000
Accrued interest		875
Shareholder's investment:		
Common Stock, par value \$100 a share:		
Authorized and issued 250 shares	\$ 25,000	
Additional paid-in capital	750,000	
Retained-earnings deficit (deduction) — Note A	(40,175)	734,825
		\$ 2,960,700

NOTE A

The Company (which commenced operations on January 15, 1966) has adopted the policy of taking service charges into income at the close of the billing cycle of accounts purchased. Accordingly, no service charges have been taken into income for the period since no accounts have been held for a full billing cycle. The retained-earnings deficit at January 29, 1966 represents the loss from operations from January 15, 1966 to January 29, 1966 and consists principally of provisions for doubtful accounts in the amount of \$39,300. \$2,126,234 of accounts were resold to the parent in February 1966 and notes payable to banks paid.

Accountants' Report

Board of Directors, The Dayton Company, Minneapolis, Minnesota

We have examined the balance sheets of The Dayton Company any retail subsidiaries, Dayton Development Company, Eighth Street Development Company and Dayton Credit Company as of January 29, 1966 and the related statements of income and retained earnings of The Dayton Company and retail subsidiaries, Dayton Development Company for the fiscal year then ended and of Eighth Street Development Company for the period of thirteen months then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheets, statements of income and statement of retained earnings present fairly the consolidated financial position of The Dayton Company and retail subsidiaries, the financial position of Dayton Development Company, Eighth Street Development Company and Dayton Credit Company as of January 29, 1966, the consolidated results of operations of The Dayton Company and retail subsidiaries and the results of operations of Dayton Development Company for the fiscal year then ended and of Eighth Street Development Company for the period of thirteen months then ended, in conformity with generally accepted accounting principles consistently applied. We have similarly examined the accompanying statement of source and application of funds for the year ended January 29, 1966 and, in our opinion, it fairly presents the information therein set forth.

Minneapolis, Minnesota, April 6, 1966

The striking bronze, "Bone Figure," by Henry Moore is central subject of the plaza entrance to Dayton's, St. Paul. The renowned sculptor's concept of "universal shapes" is back-grounded by a photograph of Dayton's Customer Service Center in Minneapolis. This is the heart of a shopping crossroads for people of the upper midwest who have patronized this store for 64 years.

Board of Directors

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BRUCE B. DAYTON
DONALD C. DAYTON
DOUGLAS J. DAYTON
GEORGE D. DAYTON, II
KENNETH N. DAYTON
WALLACE C. DAYTON
HADLAI A. HULL
STUART W. WELLS, Jr.

Corporate Officers

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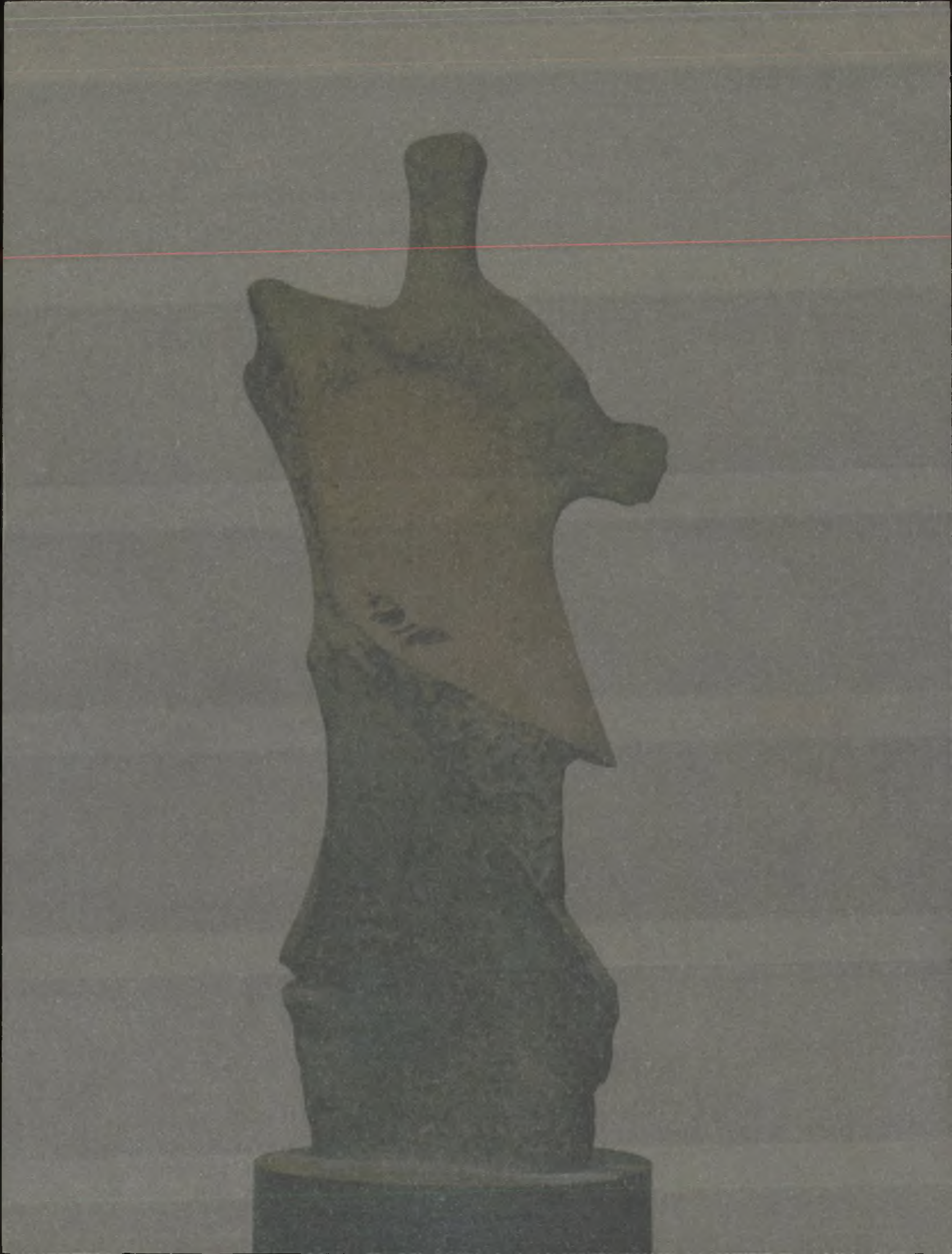
WAYNE E. THOMPSON, Vice President
STUART W. WELLS, Jr., Vice President
J. R. A. BOLINE, Assistant Secretary and Assistant Treasurer

Principal Officers of Subsidiaries

DOUGLAS J. DAYTON, President, Target Stores, Inc.
JOHN GEISSE, Vice President, Target Stores, Inc.
RICHARD KLEIN, Vice President and Controller and Assistant Secretary, Target Stores, Inc.
WILLIAM CREAR, Jr.,* President, Dayton Development Company and Eighth Street Development Company
HADLAI A. HULL, President, Dayton Credit Company

*Elected February 25, 1966

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